Analysis: China – India Income Tax Treaty

See treaty text.

Type of treaty: Income Tax
Model treaty on which based: UN
Signed: July 18, 1994
Entry into force: November 21, 1994
Entry into force (subsequent protocols): August 4, 2009 n/a (but amendments of Notification No. GSR 574(E) of 1995 incorporated
Effective date: January 1, 1995 (China); April 1, 1995 (India)

Article 1 Personal Scope

See treaty text.

Persons who are residents of one or both States.

Article 2 Taxes Covered

See treaty text.

• Taxes on total income, on elements of income;
• Taxes on gains from alienation of movable or immovable property; and
• Taxes on capital appreciation.

China

• The individual income tax;
• The income tax for enterprises with foreign investment and foreign enterprises; and
• The local income tax.

India

• The income tax including any surcharge.

As well as application to the taxes existing at the time the Treaty was signed (listed above) there is a provision applying the Treaty to any identical or substantially similar taxes which are imposed after the date of signing of this Treaty. In particular, note that China has unified its tax laws for resident and non-resident taxpayers as of January 1, 2008 so that the tax regime facing non-residents is significantly different from that which existed at the date of signing of this Treaty.

Article 3 General Definitions

See treaty text.

"China": The People's Republic of China, including its territorial sea in which the laws relating to China apply. It also includes any area beyond the territorial sea where it has sovereign rights of exploration and exploitation of resources of the seabed, its subsoil and the above-lying waters in accordance with international law.
"India": The territory of India including the territorial sea and air space above it as well as any other maritime zone in which India has sovereign rights, other rights and jurisdictions according to the Indian law and in accordance with international law.
"Person" includes an individual, a company and any other entity which is treated as a taxable unit under the domestic law of one of the States.
"Company": Any body corporate or any entity which is treated as a company or body corporate for tax purposes.
"Nationals" means all individuals possessing the nationality of one of the States and all legal persons (which would include a company), partnerships and associations deriving their status as such from the laws in force in one of the States.
Any terms not specifically defined take their meaning from the tax law of the State concerned at the time.

Article 4 Resident

See treaty text.

"Resident" means any person who is liable to tax in one of the Contracting States by reason of his domicile, residence, place of Head Office or any other criterion of a similar nature.

Residence: Individuals

In the case of individuals apparently resident in both Contracting States, the usual tiebreaker tests apply:
• He will be deemed to be a resident of the State in which he has a permanent home. If he has a permanent home in both States, he will be deemed to be resident in the State with which his personal and economic relations are closer (centre of vital interests).
• If unable to determine the State where the centre of vital interests lies, then resident of the State in which he has a habitual abode.

• If he has a habitual abode in both States, then resident in the State of which he is a national.
• If a national of both States or of neither of them, then the competent authorities must settle the question by mutual agreement.

Domestic law

India

Liability to tax under the ITA depends upon a taxpayer's residential status and is not affected by the taxpayer's nationality or domicile. An individual is regarded as resident in India in any tax year if he or she:

i) Is in India for a period or periods amounting to 182 days or more in a tax year; or

ii) Is in India for an aggregate period of 60 days or more in a tax year and has been in India for an aggregate period of 365 days or more in the four tax years preceding that tax year. In the case of an individual who is a citizen of India who leaves India in any previous year as a member of the crew of an Indian ship or for the purpose of employment outside India, or an individual who is a citizen of India, or a person of Indian origin, who, being outside India, comes on a visit in any previous year the period is extended from 60 days to 182 days.

An individual is regarded as "resident but not ordinarily resident" (NOR) in India in any tax year even though qualifying as a resident on one or both of the bases referred to above in (i) and (ii), if he or she:

• Has been a non-resident of India in nine out of the 10 tax years preceding that tax year; or
• Has during the seven tax years preceding that year, been in India for a period or periods amounting to 729 days or less.

The consequence of NOR status is that there is no liability to Indian tax on income arising outside India unless derived from a business controlled in India or from a profession set up there.

China

An individual is tax resident in China if he habitually resides there. This is taken as presence for more than one calendar year. The precise extent of exposure to and rates of Chinese tax depends on whether the individual has been present in China for more than five years without spending more than 90 days in aggregate or 30 consecutive days per calendar year outside China.

Residence: Companies

If a company appears resident in both States, e.g. because one determines residence according to the place of legal incorporation and the other according to place of management then it will be deemed to be resident in the State in which its Head Office is located.

Domestic law

India

Entities classed as Indian companies are automatically tax resident. These are companies formed and registered under Indian law, any institutions, associations or bodies declared by the CBDT (Central Board of Direct Taxes) to be companies with their registered or principal office in India.

Other foreign companies may be considered tax resident in India if managed and controlled wholly in India.

China

Companies incorporated in China are considered tax resident. Additionally, under the Corporate Income Tax Law which became effective as of January 1, 2008, China now determines company residence according to the place of effective management. This is interpreted as the exercise of the overall management and control of production, business, employees, finance and assets of a company (Articles 2 and 3 of the CITL). Thus day to day control as well as strategic management must be considered and the definition is very broad.

Partnerships and fiscally transparent enterprises

Residence is to be determined as for companies.

India

A Hindu Undivided Family/Firm/Association of Persons is regarded as resident in India unless its control and management is situated wholly outside India. A Hindu Undivided Family may also have "resident but not ordinarily resident" status if it has been non-resident for nine out of the previous 10 years or has been in India for a period totally less than 729 days during the seven years preceding the current year.

Partnerships are considered separate taxable entities but unless the partnership instrument specifies the profit sharing arrangements, the partnership is taxed according to the marginal tax rates of the individual partners. However, note that partnerships are not often used by foreign investors.

China

The default position is that partnerships are treated as transparent unless an election is made for the partnership to be taxed as a separate entity.

Article 5 Permanent Establishment

See treaty text.

Note: Particular care is needed when determining whether a permanent establishment exists in India and in determining the amount of profits to be attributed to it. See the extensive notes under Article 7.

This Article defines the term "permanent establishment". The profits of an enterprise of one of the Contracting States can only be taxed on an arising basis in the other Contracting State to the extent that they are attributable to a permanent establishment in that other State.

This Treaty broadly uses the UN definitions. Three types of permanent establishment are envisaged: A fixed place of business, a service permanent establishment and an agency permanent establishment.

Fixed placed of business

In this context a "permanent establishment" means a fixed place of business through which the business of the enterprise is wholly or partly carried on. The list of types of establishment particularly included follows the UN model and includes:

• A place of management;
• A branch;
• An office;
• A factory;
• A workshop;
• A mine, an oil or gas well, a quarry or any other place of extraction of natural resources;
• A warehouse, in relation to a person providing storage facilities for others
• A farm, plantation or other place where agriculture, forestry, plantation or related activities are carried on; and
• An installation or structure used for the exploration or exploitation of natural resources, but only if used for a period of more than 183 days.

A building site, construction or assembly or installation project which lasts (together with other such sites, projects or activities for more than 183 days will also be regarded as a fixed place of business. Supervisory activities in connection with such activities are also included. Note the departure here from the more usual period of 12 months, reflecting the use of the UN Model Convention. Note also the requirement to take into account other sites, with no requirement that they be connected. This suggests a "force of attraction rule whereby activities that would not, of themselves, result in any tax liability in India may nonetheless be drawn into the net by virtue of being aggregated with other activities. Note also that the 183 day period is cumulative without having to occur within a specified time period.

According to the OECD Commentary, a "fixed place of business" means established at a distinct place with a certain degree of permanence, however, it could be a pitch in a market place, or even part of the premises of another enterprise. There is no requirement that the premises be owned. The Commentary offers the example of an employee of Company A who is allowed to use an office at the premises of Company B. This could create a permanent establishment for Company A in the country of Company B if the arrangement persists for long enough and if the employee is carrying out activities which are more than merely "preparatory or auxiliary" (see below).

The OECD considers that to be fixed, a place of business must be at a specific geographic point. However, if the permanent establishment consists of mechanical equipment only, then there is no requirement for mechanical equipment to be fixed to the soil.

As to what constitutes a reasonable period of time to give the necessary degree of permanence, most countries will not consider a presence of less than six months to give rise to a fixed place.

The usual exclusions from the definition of permanent establishment are given so that the following will not constitute a permanent establishment but note the remarks made below concerning warehouses and delivery of goods:

a) The use of facilities solely for the purposes of storage, display or delivery of goods or merchandise belonging to the enterprise;
b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
d) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise; and

e) The maintenance of a fixed place of business solely for the purpose of carrying on any other activity of a preparatory or auxiliary character.
To apply this Article, it is necessary to be able to make a distinction between functions that are core to a business and those that are merely preparatory or auxiliary. What constitutes core functions will vary from one business to the next. However, any fixed place of business from which the business is partly managed will constitute a permanent establishment even if its function otherwise appears to be preparatory or auxiliary. Also, if services are rendered to other companies within the corporate group or to third party customers then this would not be preparatory or auxiliary because activities only count as preparatory or auxiliary if they are carried on "for the enterprise" itself.
Note that despite incorporating many features of the UN Model Convention, this Article at paragraph 3 (a) and (b), unlike the UN Model and other Indian treaties, excludes "delivery of goods or merchandise" from the definition of what may be considered a permanent establishment.

Service permanent establishment

This Treaty follows the UN Model in specifically providing that services provided by an enterprise may result in a permanent establishment, even though there is no fixed place of business.
The furnishing of managerial and other services, whether through an enterprise's own employees or by other personnel will give rise to a permanent establishment where the activities last for a period or periods aggregating more than 183 days. Again, there is no time period specified within which the 183 days must fall so that once an enterprise has been furnishing services within the other State for a total of more than 183 days it will always be assumed to have a permanent establishment there in that respect. Nor is there any statement that the 183 days refers to work on a single project or several projects which are connected. Thus a number of unconnected assignments could give rise to a permanent establishment for the foreign enterprise if the number of days spent on them in the other State exceeds 183 days in total.

Agency permanent establishment

Dependent agents may constitute a permanent establishment. Where a person is acting on behalf of a resident of a Contracting State and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the resident, that resident is deemed to have a permanent establishment in that other State. There is no specific exclusion from this rule for purchase contracts made on behalf of the enterprise although they should be covered under the "preparatory or auxiliary" exclusion as set out above. Activities as listed a) to e) above which are "preparatory or auxiliary" will not give rise to an agency permanent establishment.
Where the activities of the agent are merely preparatory or auxiliary, or where the agent is an independent agent (e.g. a general commission agent acting in the ordinary course of his business) the presence of the agent will not give rise to a permanent establishment. However, if the activities of the agent are carried out wholly, or almost wholly for the enterprise (or the enterprise and any of its associated companies) then he will be considered to be a dependent agent.

General

Note the absence of the inclusion of a sales outlet or the soliciting of orders from the list of instances giving rise to a permanent establishment.
The fact that a company has a subsidiary in the other Contracting State does not mean that the subsidiary is a permanent establishment of that company, unless it binds the parent company in contract as per the rule for dependent agents. This rule applies generally to groups of companies.
Note that India has been very active in asserting the existence of permanent establishments of non-resident parent companies by reason of the activities of their Indian resident subsidiaries note also that the 100% owned subsidiary is the principal route for direct investment into India.

Article 6 Income From Immovable Property

See treaty text.

The general rule is that income derived by a resident of a Contracting State from immovable property in the other State may be taxed in that other State. Thus, for instance, if a resident of one State owns a building in the other State and receives rent, that rent may be taxable in the other State. This treatment also applies to income from immovable property used by an enterprise and to income from immovable property used for the performance of independent personal services. Immovable property is given its usual definition to include livestock, and agricultural equipment and the rights to payments from the working of natural resources (*inter alia*). This Article also includes an express provision that immovable property is, in the first instance, to be defined in accordance with domestic law.
There is no extension giving the Situs State any right to tax income from movable property of a permanent establishment.

Article 7 Business Profits

See treaty text.

Only profits actually arising from a permanent establishment may be taxed by the source State. The wording used is profits "directly or indirectly" attributable to the permanent establishment. This is not explained further but in other Indian tax treaties, the phrase "indirectly attributable" is interpreted as meaning that where a permanent establishment takes an active part in negotiating, concluding or fulfilling contracts entered into by the enterprise then a proportion of the profits of the enterprise which arise out of those contracts will be attributed to the permanent establishment. The proportion is normally found by comparing the contribution of the permanent establishment to the contribution by the whole enterprise.

This stops short of being a full blown "force of attraction" rule, whereby any activities of an enterprise in the other State would be attributed to a permanent establishment which it has there. The second sentence of paragraph 1 states that profits are not to be attributed to a permanent establishment if the enterprise proves that the activities in question could not have been undertaken by the permanent establishment or that those other activities of the enterprise have no relation with the permanent establishment.

Paragraph 2 sets out the usual rule that the profits to be directly attributed to the permanent establishment are the profits that would be expected if the permanent establishment was a distinct and separate enterprise. The starting point for the computation will be the branch accounts. Provided there is symmetry in the amounts recorded and in the methods of valuation applied in recording the transactions in the books of the different parts of the enterprise, the accounts will normally be an acceptable basis for attributing profit to the permanent establishment. However, any assumptions used in maintaining branch accounts, for instance, an assumption that the branch acts as principal in all cases, when in fact it only acts as intermediary would lead to a downwards adjustment in profit allocated to the branch.

Paragraph 3 permits a state to tax a permanent establishment on the basis of a deemed profit where this is provided for under domestic law, as in India – see the country notes below.

The usual provision providing for the deduction of expenses from the profits of the permanent establishment in accordance with the rules laid down by domestic law is present at paragraph 4. Deductions for executive and general administrative expenses are permitted whether incurred in the State where the permanent establishment is situated or elsewhere.

Although this Treaty uses elements of the UN Model as well as the OECD Model, the recent OECD work on attribution of profits to permanent establishments is relevant to this treaty. The aspects of Article 7 of this Treaty which are based on the UN Model are those concerned with the deductibility of expenses in arriving at the taxable profits. The Commentary on the UN Model relating to the rules on deductibility of expenses makes it clear that the extra provisions are present so that all necessary definitions and clarifications on this matter are set out in the text of the Treaty rather than merely in a Commentary. The central aim of Article 7 in this Treaty is identical to that in the OECD Model Convention: The profits attributable to a permanent establishment are those which would be earned by the establishment if it were a wholly independent entity dealing with its head office as if it were a distinct and separate enterprise operating under conditions and selling at prices prevailing in the regular market (per Paragraph 2 of Commentary on Art 7, UN Model).

The OECD, in 2008, published its final report on the attribution of profits to permanent establishments (July 17, 2008) and updated the Commentary on Article 7 of the Model Treaty. When interpreting a tax treaty, it is generally agreed that the latest version of the OECD's Commentary on the Model Treaty should be used. These notes follow the 2008 version of the Commentary. The "authorised OECD approach" to attributing profits to a permanent establishment now requires that there is a two step process.

Firstly, a functional and factual analysis should be carried out, along the lines set out in the OECD's transfer pricing guidelines, to establish the economically significant activities and responsibilities undertaken by the permanent establishment. This will involve establishing the rights and obligations arising out of transactions between the permanent establishment and third parties, e.g. the sales revenue arising from independent customers generated by the permanent establishment as opposed to by the head office. If the permanent establishment takes the form of a factory, then it would assume the obligation to pay for the raw materials which it uses. The OECD then recommends that "significant people functions" relevant to the attribution of economic ownership of assets are identified to support the attribution of economic ownership of assets of the enterprise to the permanent establishment. Economic ownership is defined as the right to income from an asset or the right to depreciate it. Tangible property should be attributed to the location where it is in use. Economic

ownership of intangibles rests with the location in which the risks associated with the intangibles is borne: For instance, if an enterprise owns a patent for a particular drug which is sold by distributor companies in many countries, the economic ownership would rest in that part of the enterprise responsible for commissioning the research to develop the drug and which would bear the losses if medical trials failed. A further set of "significant people functions" are then to be identified: This time, those relevant to the assumption of risks so that an allocation of risks borne by the enterprise can be made to the permanent establishment. For instance, road building equipment may be economically owned by a permanent establishment in Country A but the head office, located in Country B, may have the power to determine on which road building projects the equipment is used and hence the head office bears the risk associated with profits or losses arising from the equipment. The more risks that are managed by the permanent establishment, the higher the share of the profit of the enterprise to be attributed to it. The OECD's 2008 Report looks for the place of active decision taking rather than mere "rubber stamping". Note that no such distinction between asset management and risk assumption functions is required in the case of enterprises in the financial sector, because it is considered highly likely that these functions would be carried out by the same people.
Secondly, taking into account the picture built up in the functional and factual analysis, the profits of the permanent establishment must be determined. Although this is relatively simple in the case of transactions with third parties, transactions and dealings with other parts of the enterprise must be determined using the rules laid down in the OECD's Transfer Pricing Guidelines. This means that goods and services provided by head office must carry an arm's length mark up. Pricing policies should be properly documented, which in practice may prove troublesome as firms may not take the same care in documenting the terms of transactions within the firm as they would with third parties. In determining the profits attributable to the permanent establishment, part of the enterprise's interest costs on its borrowings should be allocated to the permanent establishment. The amount of capital needed to support functions carried out by the permanent establishment on the assumption that it is a separate entity must be calculated. Then, this total theoretical capital must be broken down into debt and equity (or "free capital" in OECD terms). The greater the risks undertaken by the permanent establishment, the higher the proportion of its notional capital that will be regarded as "free capital". Several methods of establishing the split between "free capital" and debt capital are suggested, including the use of thin capitalisation practices in the State in which the permanent establishment is located. Once the amount of notional debt capital has been determined, an allocation of the enterprise's interest liabilities can be made to the permanent establishment. Note that only actual interest liabilities can be allocated. If the enterprise as a whole has paid no interest to external lenders, then there can be no allocation of interest liability to the permanent establishment. The only exception to this rule is where the permanent establishment is involved in treasury dealings with other parts of the enterprise. Whilst this may well be the case in banking enterprises, it would be unusual in other enterprises. Generally, the interest rates used and the terms of the notional loans to the permanent establishment must be such as would be found between parties dealing at arm's length.
When deciding what transactions should be recognised between the permanent establishment and other parts of the enterprise, the OECD recommends that the only internal transactions which can be recognised in arriving at the permanent establishment's profits are those which relate to real and identifiable events. These would include the physical transfer of goods, the provision of services, the use of intangibles and the transfer of financial assets. Whilst the internal records (e.g. the branch accounts) are the starting point for identifying these transactions, the true test is whether there has been an internal dealing of economic significance. The OECD's 2008 report suggests the following tests are used when considering whether an internal dealing should have any effect on the profits of a permanent establishment:
1) Is the documentation consistent with the economic substance of the internal dealings?
2) Are the arrangements such that they are not too different from dealing which one group company might have with a fellow group company? For instance, credit periods should be similar in similar circumstances.
3) Are the dealings consistent with the OECD principles for attributing profits to permanent establishments?
Allocations of head office expenses, e.g. for strategic management or centrally managed support functions such as payroll, may be set against the profits of the permanent establishment, but the arm's length principle must be observed.

The allocation of profits to dependent agent permanent establishments

A dependent agent is not part of the taxpayer enterprise and will file his tax returns independently. Normally the enterprise will make payments to the agent for his services. The question is: Should the

host State merely tax the profits of the agent (the “single taxpayer approach” or should there be an additional charge on the enterprise which is using the services of the agent? The amount of the charge would depend on the excess of the enterprise's profits over the amount paid to the agent which was attributable to the activities of the agent. For instance, a dependent agent may be paid for the sales he procures on a commission basis, but the selling enterprise may make a profit on those sales even after taking into account the (arm's length) commission paid to the agent. The OECD recommends that States should always consider whether the enterprise has made a profit in respect of business transacted via the agent which is in excess of amounts paid to the agent. Hence the host State may tax both the dependent agent and the foreign enterprise.
As is usual no profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.
The same method of attribution is to be used year by year unless there is good and sufficient reason to the contrary.
The rule in paragraph 7, that where profits include items of income dealt with separately in other Articles of this Convention those Articles take precedence over the rules in Article 7, takes on particular significance in Indian treaties. Particular care is needed in the definition of whether payments are to be treated as general profits or as fees for technical services. These fees are subject to withholding tax under Article 12.

Domestic law

India

Extreme care is needed when structuring business transactions involving India to ensure that a permanent establishment does not arise where none as intended and that the attribution of profits to the permanent establishment is as anticipated by the non-resident enterprise.
India is well known for its use of the source principle. In addition to the use of the UN Model for its double tax treaties, which invariably include the concept of a service permanent establishment, there have been many cases where India has used its domestic law to interpret the provisions of its treaties so as to assert the existence of a permanent establishment. Because the predominant form of inward investment into India is the wholly owned subsidiary, the central argument in these cases is often that the Indian subsidiary is acting as a permanent establishment of the foreign parent in some way.
Section 9 of the Income Tax Act provides that income from any business connections in India is deemed to arise in India. This is so irrespective of whether income actually arises in India. Where profits arise partly in India and partly abroad India will tax an amount that is “reasonably attributable” to the business operations carried out in India. There is no statutory definition of “reasonably attributable”. Profits of a permanent establishment are determined by reference to the branch accounts. These must be kept as if the permanent establishment were an Indian company. Head Office expenses: The deduction for these is generally limited to 5% of total income of the permanent establishment, by section 44C of the ITA.
If suitable branch accounts are not kept, then Rule 10 of the Income Tax Rules 1962 provides that there are three methods of determining the profits of an Indian permanent establishment: A presumptive method, a proportionate method and a discretionary method. These methods give estimates of the profits attributable to the permanent establishment. There is little guidance as to the situations in which Rule 10 might be invoked other than that it can be used either when branch accounts are not available or not considered a suitable basis for assessing the tax liability of the permanent establishment.
The presumptive method is used generally in Indian tax law and usually works by estimating taxable profits as a percentage of turnover, by reference to average margins achieved in the trade in question. The proportionate method is a unitary method which apportions profits of the whole entity by reference to the proportion of turnover achieved in India. Discretionary methods are not specified. Because of the use of the presumptive method in Indian domestic tax situations, this is likely to be the method chosen if, for some reason, the taxable profits of the permanent establishment cannot be ascertained by reference to Indian branch accounts.
In the case of *Rolls Royce plc* (ITA Nos. 1496 – 1501/ DEL of 2007) discussed in the analysis under Article 5, the UK company had not considered that it had a permanent establishment in India and had therefore kept no branch accounts. Thus Rule 10 was invoked. The goods (aero engines) were not manufactured in India and the Court allocated 50% of the profits on the sales attributed to the permanent establishment to manufacturing costs incurred outside India, 15% to R&D costs incurred outside India, leaving 35% of the profits to be attributed to the Indian permanent establishment.

The concept of a "business connection" is key in establishing whether any of the profits of an enteprise are subject to tax in India. If a business connection exists, then part of the profits of a foreign enterprise may be deemed to arise in India. Explanation (a) to Section 9 (1) of the ITA states that income reasonably attributable to the operations carried out in India will be taxable there, if a business connection exists. However, exactly what type of business operation may give rise to a liability to Indian tax is not entirely clear. Particular problems have arisen with the precise manner in which foreign enterprises secure and conclude contracts with Indian customers. Generally, the Indian view of operations which. to use tax treaty terminology, are "merely preparatory or auxiliary" is much narrower than that of most other countries. A well known quote from the case *CIT*, *Punjab, v R.D. Aggarwal & Co* ([1965] 56 ITR 20) provides some clues:
"The expression "business connection" postulates a real and intimate relation between the trading activity carried on outside the taxable territories and the trading activities within the territories, the relation between the two contributing to the earning of income by the non-resident in his trading activity".
Some examples, taken from case law on the topic, of when a business connection might or might not be deemed to exist are given below:
(i) Such a connection exists when regular purchases are made in India through a regular agency. However, the mere procurement of orders on behalf of foreign principals does not establish a business connection.
(ii) Where a company in India and a company outside India are both controlled by the same person and there is a flow of business between the two, there is a business connection even if the transaction between them is finalised outside India.
(iii) A solitary loan transaction between a resident and a non-resident does not constitute a business connection between them, even if that loan and interest were to be paid over a period of, for example, five years.
(iv) Where goods are sold by a non-resident through an agency for only one year, a business connection exists if a large number of orders are placed.
(v) A managing agent of a foreign company in India constitutes a business connection.
(vi) In circumstances where there was regular correspondence between a firm of solicitors in India and a firm of solicitors in London regarding evidence to be adduced in certain suits and fixing hearings when a counsel from London would attend, a business connection was held to exist.
(vii) In circumstances where technical information was provided by a German firm to an Indian firm in Germany, no business connection was held to exist.
(viii) A business connection exists where a non-resident maintains a branch office in India for the purchase and sale of goods, or for transacting other business.
(ix) Normally, when a non-resident deals with an Indian resident on the basis of principal-to-principal, such an arrangement *prima facie* negates the existence of any business connection.
(x) When an Indian broker is free to place the orders secured by him with any person he likes and he places his orders with a non-resident taxpayer, the relationship between them is not a business connection.
Agency permanent establishments may be held to exist in circumstances not envisaged by the taxpayer. Section 185 of the ITA specifies the persons who may be treated as an agent, and it includes any person who has any business connection with the non-resident, or from or through whom the non-resident is in receipt of any income, whether directly or indirectly. If an Indian permanent establishment is to be avoided, the safest way to sell goods in India or otherwise conclude contracts is on a principal to principal basis. There are numerous Indian court cases on the subject of whether agency or service permanent establishments exist and also numerous decisions of the AAR (Authority for Advance Rulings).
A recent major decision of the Indian Supreme Court on a disputed AAR ruling concerned Morgan Stanley, the investment bank, which applied for a ruling as to whether or not it had a permanent establishment in India (AAR 661 of 2006). Very briefly, the facts were that Morgan Stanley Co seconded certain employees to an Indian subsidiary which provided it with support services for periods of up to two years in order to ensure the quality of the support services provided. They were employed by and paid by the Indian subsidiary and their salaries were recharged to the parent company without any profit element. It was agreed that neither a "fixed place of business" nor an agency permanent establishment arose, but that there was a services permanent establishment. The grounds for this decision were mainly that the salaries of the seconded employees were, in fact, paid by the Indian subsidiary, constituting around 50% of the wages bill, their performance appraisals were conducted by the Indian subsidiary and they undertook part of the managerial activities of the Indian

subsidiary. The fact that the value of their work was exclusively for the benefit of Morgan Stanley Co was, in the opinion of the AAR, not enough to prevent a permanent establishment being held to exist. Whilst this was confirmed in 2008 by the Indian Supreme Court, the Supreme Court ruled that the amount of the payments by Morgan Stanley Co to the Indian subsidiary were on an arm's length basis and thus no further profit beyond those resulting from these payments could be taxed in India. This decision followed a close analysis of the transfer pricing principles used and concluded in arriving at the arm's length price the key concepts to be examined were the functions performed and risks assumed by the service permanent establishment.

The payment of an agent at an arm's length amount may not be sufficient to prevent a permanent establishment being held to exist, as in *Dy Director of Income Tax v SET Satellite (Singapore) Pte Ltd.*), a 2007 Tribunal case. In this case, SET made arm's length payments to a dependent agent in India but was faced with an Indian tax assessment (under Rule 10) of 10% of the advertising revenues generated by the agent. Although the question of whether payments to an agent representing an arm's length amount had been explored in the Morgan Stanley ruling (separately from the salaries issue discussed above) and it had been held that such payments would extinguish any further liability in respect of the profits generated by the dependent agent's activities, the benefit of this ruling was not extended to SET. Rulings of the AAR are only applicable to the requesting party, not to taxpayers generally.

Note that the attribution of profits to operations outsourced ("offshored") to Indian, typically call centres and back office operations, is specifically addressed in two Circulars, Circular No. 1 of 2004 and Circular No. 5 of 2004.

This analysis constitutes a superficial summary of the position regarding the existence of and the attribution of profits to an Indian permanent establishment. New cases are being brought all the time.

For a non-resident, only that income is subject to tax in India that, inter alia, accrues or arises, or is deemed to accrue or arise in India. (Section 5 of the Act.) In this regard, any income accruing or arising, directly or indirectly, through or from a "business connection" in India to a non-resident, is deemed to accrue or arise in India and hence, such income is taxable in India. (Section 9 of the Act.) The term "business connection" is very wide and what constitutes business connection has been the subject matter of judicial scrutiny in a large number of cases. Business connection may take several forms; it may include carrying on a part of the main business, or activity incidental to the main business of the non-resident through an agent, or it may be a relation between the business of the non-resident and the activity in India, which facilitates or assists the carrying on of that business. (*CIT v. R. D. Aggarwal & Co*. [1965] 56 ITR 20.) However, when the non-resident is entitled to relief under a tax treaty, the provisions of the Act only apply if they are more beneficial to the taxpayer. (Section 90(2) of the Act.) If a non resident entity is reckoned as having a PE in India, only the following business profits can be subject to tax in India:

(i) the income attributable to the PE;

(ii) the income generated from the sale of goods, etc., of the same or similar kind as those sold through the PE; and

(iii) the income from other business activities carried on by the non-resident entity in India of the same or similar kind as those effected through the PE. (Article 7(1) of the DTAA).

Further, the income attributable to the PE will be the income which the PE might be expected to generate if it were dealing at an arm's length basis with the non-resident. (Article 7(2) of the DTAA.)

India's Supreme Court in the case of Morgan Stanley ((*DIT v. Morgan Stanley Co. Inc*., 292 ITR 406 (2007), held that no further income will be attributable to a Service PE (occasioned due to the secondment of employees of an American company to its Indian subsidiary) of an American enterprise if the dealings between the American enterprise and its Indian subsidiary are being conducted at arm's length. However, it also held that the situation would be different if the transfer pricing analysis does not adequately reflect the functions performed and the risks assumed by the enterprise. In such a case, there would be a need to attribute profits to the PE for those functions/risks that have not been considered.

Further, in the judicial cases of Galileo (*Galileo International v. DCIT*, 2007 TIOL-447- ITAT Del.) and Amadeus (*Amadeus Global Travel Distribution v. DCIT*, (2008) 113 TTJ (Delhi) 767), apart from an Equipment PE (on account of computers provided to agents), the foreign companies were held to have an Agency PE in India on a dependent agency theory. Having said so, they were compensating the Indian agent on an arm's length basis. Accordingly, the Delhi Bench of the ITAT held that no further profits would be attributable to the PE in India. While arriving at this conclusion, the ITAT relied on a circular issued by the tax authorities that stated that no further profits of a foreign enterprise are to be taxed in India, where the remuneration of the agent fully represented the value of the profits

attributable to the service provided by the agent. (Circular Number 23, dated July 23, 1969, issued by the Central Board of Direct Taxes.) They also relied on a similar judgment of the Bombay High Court rendered in the context of the India - Singapore DTAA. *(SET Satellite (Singapore) Pte Ltd. v. DDIT*, (2008) 110 BOM LR 2726.) Therefore, based on Morgan Stanley's ruling, if the non-resident entity compensates the Indian entity on an arm's length basis adequately reflecting the functions performed and the risks assumed by the Indian entity, it is more likely than not that no income of the non-resident entity will be brought to tax in India, if a PE is occasioned. However, this will depend on the fact pattern of each case. Further, Morgan Stanley, as such, related to a Service PE issue. Additionally, the circular relied on by the Tribunal in the above mentioned cases has since been withdrawn.
In a situation, where the tax authorities seek to calculate the taxable income under the Act and the rules made there under they can resort to either one (1) of the following three (3) methods:
(i) Presumptive method - tax authorities ascertain a reasonable percentage of the turnover;
(ii) Proportionate method - the tax authorities ascertain the profits on the basis of the ratio between global turnover and Indian turnover; and
(iii) If none of the above two (2) methods work, the tax authorities may use such other method as they may "deem fit." (Rule 10 of the Income Tax Rules, 1962.)

China

The general rule is that permanent establishments are taxed on Chinese source income only. The rules of the Enterprise Income Tax Law are applicable to permanent establishments. The term used in domestic law is "establishments or sites". It has been the practice to limit the use of permanent establishments by foreign enterprises in favour of corporate forms and joint ventures although this appears to be changing. Note that representative offices have been widely used and there are detailed rules for determining the taxable profits of such an office.

Article 8 Shipping And Air Transport

See treaty text.

Not analysed.

Article 9 Associated Enterprises

See treaty text.

This contains the usual OECD provisions regarding transfer pricing. Associated enterprises must adopt the arm's length principle in their dealings with each other, and to the extent that they do not, a Contracting State may make an upwards adjustment to taxable profits.
Paragraph 2 makes specific provision for a corresponding downwards adjustment to taxable profits by the other State, with reference to the mutual agreement procedure provided for at Article 25 if necessary.

Article 10 Dividends

See treaty text.

This Article provides for the source State to levy withholding tax on dividends paid to a resident of the other Contracting State at rates which may be lower than that charged under domestic law. The recipient of the dividend must also be the beneficial owner.
Withholding tax under this Treaty: 10%.
Paragraph (3) defines the term "dividends" to include income from shares or other rights (which are not debt-claims) which participate in profits. Also included is income from other corporate rights which is treated as income from shares under the law of the State in which the distributing company is tax resident.
Paragraph (4) provides that where, say, an Indian company receives a dividend from a Chinese company, and that dividend is effectively connected with a permanent establishment which the Indian company has in China, then the dividend income will be deemed to be part of the income of the permanent establishment and the provisions of Articles 7 or 14 dealing with the attribution of business profits will apply.
Paragraph (5) contains the usual provision that a State does not have the right to levy any tax on a dividend unless either the dividend is paid by a resident company or received by a resident shareholder. Thus the fact that a dividend paid by an Indian company may be sourced from profits earned by a permanent establishment which that Indian company has in China, does not give China any taxing rights over that dividend, unless of course, it is received by Chinese shareholders.

Domestic law

India

Withholding tax is not charged provided the paying company has paid dividend distribution tax. The basic rate is 15% but is subject to various additions which vary from year to year. A total rate of around 17% is usual.

China

Per Article 4 of CITL which came into effect on January 1, 2008: 10% withholding tax.

This replaces the previous exemption from withholding tax for dividends.

Dividends received from a qualified High-New Technology resident company may be exempt. Such a company must:

• Own core proprietary intellectual property in China;

• Be recognised as coming within the scope of High-New technology as defined by the Chinese Government;

• Have an annual R&D outlay of at least 3% – 6% of the annual turnover (the exact percentage varies with the amount of the turnover);

• Have income from High-New technology products which account for more than 60% of its income; and

• More than 30% of the employees must be graduates, with employees involved in R&D accounting for more than 20% of total employees.

Article 11 Interest

See treaty text.

This Convention provides for withholding tax rates below those which would be applied by virtue of domestic law.

To qualify for the reduced rate of withholding tax under this Treaty the recipient of the interest must also be the beneficial owner.

Rates are:

0% for interest paid:

• To the Chinese or Indian Governments, their local authorities, central banks and other wholly Government owned financial institutions; and

• In respect of any debt-claim indirectly financed by any of the above.

10% in all other cases.

Interest is defined as income from debt-claims of every kind whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits. The term includes income from government securities, bonds and debentures and premiums and prizes attaching to these securities as well as other bonds and debentures. Penalties for late payment are not to be regarded as interest.

There are the usual provisions such that interest received by a non-resident but which relates to a permanent establishment which that non-resident has in the other Contracting State is taxed under Article 7 and thus escapes withholding tax. Also, interest paid by an enterprise which is borne by a permanent establishment is deemed to arise in the State in which the permanent establishment is situated. Hence, if the permanent establishment and the recipient are in the same State, no withholding tax can arise.

As is usual under the Model Conventions, there is a provision limiting the treaty benefit to an arm's length amount of interest where there is a special relationship between the payer and the beneficial owner.

Domestic law

India

Withholding tax of 20% plus some surcharges which give an effective rate of just over 21%.

China

Withholding tax of 10%, unless paid in connection with a permanent establishment which the recipient has in China. Interest on certain governmental loans may be exempt.

Article 12 Royalties And Fees For Technical Services

See treaty text.

This Article provides for the source State to levy withholding tax on royalties and fees for technical services paid to a resident of the other Contracting State at a rate which may be lower than that charged under domestic law.

Withholding tax, provided the recipient is the beneficial owner: 10%.

Royalties are defined as payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematograph films and films or tapes for television or radio broadcasting, any patent, trade mark, design or model, plan, secret formula or process, for information concerning industrial, commercial or scientific experience. It also

included payments in connection with the use of or for the right to use any industrial, commercial or scientific equipment.
"Fees for technical services" are defined as payments of any kind to any person in consideration for services of a managerial, technical or consultancy nature. It includes the provision of services of technical or other personnel. It does not include amounts treated as fees for independent personal services or as salary. Any other type of services may be taxable under Article 7.
There are the usual provisions such that royalties received by a non-resident but which relate to a permanent establishment which that non-resident has in the other Contracting State are taxed under Article 7 and thus escape withholding tax. Also, royalties paid by an enterprise which are borne by a permanent establishment are deemed to arise in the State in which the permanent establishment is situated. Hence, if the permanent establishment and the recipient are in the same State, no withholding tax can arise.
Where the payer and beneficial owner are connected and the amount of royalties exceeds an arm's length amount, the excess amount paid will not enjoy the treaty benefits and will be liable to tax in the payer's State at the normal domestic rate of withholding tax.

Domestic law

India

Withholding tax of 10% plus some surcharges, giving an effective rate of about 10.5%. This rate also applies to payments for technical services.

China

Withholding tax of 10%.

Article 13 Capital Gains

See treaty text.

The usual rule that gains derived by a resident of a Contracting State from the disposal (alienation) of immovable property as defined in Article 6 and situated in the other Contracting State may be taxed by that State applies.
The term "alienation" is used in connection with events giving rise to capital gains. This will include normal disposals of assets and also events such as exchange of assets, expropriation, gifts and the passing of assets to another on death. Not all States levy tax in all these situations, but the meaning of the term "alienation" is sufficiently wide to give them the right to do so if their domestic law provides for a charge to tax in a particular situation.
Also applicable is the usual rule that gains on alienation of movable property forming part of the assets of a permanent establishment may be taxed by the Contracting State where the permanent establishment is situated, including gains from the alienation of the permanent establishment, whether or not as part of the alienation of the whole enterprise. Thus, for example, the sale of a wholly owned company resident in State A and owned by a resident of State A could give rise to a tax charge in State B if that company has a permanent establishment in State B.
Gains from the disposal (alienation) of shares in a company whose underlying assets consist mainly (whether directly or indirectly) of immovable property situated in the other State may be taxed by the State in which the property is located.
Gains on the alienation of any other property may taxed in the State in which they arise. This is the UN Model rule. Apart from this, all other gains are taxable only in the State where the alienator is resident.

Domestic law

India

Non-residents are taxed on short-term capital gains on listed shares but long term (held for more than one year) gains are exempt in the case of non-resident institutional investors.
Capital gains from the transfer of assets located in India are deemed to arise in India. This is especially significant because the Indian Tax Office are attempting to "look through" the sale of offshore holding companies whose underlying assets consist of shares in Indian companies. There is a requirement for vendors to withhold tax (10% or 20% depending on whether the gain is short term or long term). In December 2008, the Bombay High Court held in the case of *Vodafone International Holdings B.V., Netherlands v Assistant Director of Income Tax (International Taxation)* (2008 TIOL 602 HC MUM IT) that withholding tax is due from a vendor even if neither the vendor nor the purchase is tax resident in India. All that is necessary is that the property changing hands should be located in India. In this case, the property which was indirectly being purchased was Hutchison Essar, an Indian mobile phone company. 67% of whose shares were held by CGP, a Cayman Islands subsidiary of a Cayman Islands company. The Cayman Islands parent company sold CGP to Vodafone BV, a Netherlands company. The tax being sought from Vodafone is approximately $2 billion and indications

are that the Indian tax authorities regard this as a test case, proceedings having already started in 2009 against other vendors in similar positions. Vodafone appealed on the grounds that since the purchaser was a Netherlands company and the vendor a Cayman Islands company, India has no jurisdiction to tax. A further complication in this case is that India altered its tax laws (section 210 of the Income Tax Act) with retrospective effect in order to be able to demand tax from the purchaser (in the form of withholding tax) rather than merely from the vendor.
The Bombay High Court used the "effects doctrine" sometimes used in US anti-trust cases to justify the tax assessment on Vodafone. As at February 2009, Vodafone's appeal to the Indian Supreme Court has been rejected but the High Court has been directed by the Supreme Court to reconsider whether India really does have the right to tax the gain. The key point for planners at present is to proceed very cautiously when Indian Situs property is changing hands, even if the sale is effected indirectly between persons not resident in India. The principle being asserted by India is that if the property being sold is ultimately Indian Situs property, then Indian tax on the capital gain is due.
China
Non-residents are taxed on gains on the disposal of Chinese property via a withholding tax.

Article 14 Independent Personal Services

See treaty text.
This Treaty has separate Articles governing the taxation of income from permanent establishments (see Articles 5 and 7) and income from professional services. This Article provides that where a resident of one of the States has a "fixed base" in the other State, income in respect of professional services attributable to that fixed base may be taxed in the country in which it is situated. Thus an Indian accountant with an office in China will be taxable in China on profits attributable to the Chinese office. The attribution of profits is dealt with in the same way as for other business profits under the provisions of Article 7.
This treatment will also apply to professional services performed in the other State by individuals present in the other State for more than 183 days in aggregate in the taxable year concerned but only to that part of the income of the person which is derived in the other State.
The term "professional services" is defined to include especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Article 15 Dependent Personal Services

See treaty text.
Salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of employment are taxable only in that State unless the employment is exercised in the other State. If so, remuneration derived from the other State is taxable in the other State. However, the other State (the source State) will not tax provided:
• The recipient is present in the other State for no more than 183 days in aggregate in the taxable year concerned;
• The remuneration is paid by, or on behalf of, an employer not resident in the other State; and
• The remuneration is not deductible in computing the profits of a permanent establishment or a fixed base which the employer has in the other State.
The purpose of this Article is to ensure symmetry in taxation. If the employer is not taxable in a State, because it is neither resident there nor has a permanent establishment there then it will not receive any tax deduction in that State for wages and salaries paid. Wages and salaries paid by the employer in respect of short term employment postings of employees to that State are correspondingly exempted from tax in that State in the hands of the employee.
The interpretation of this Article poses some difficulties due to the use of presumptive taxation in some areas of Indian income tax law. Presumptive taxation is a system whereby tax is levied based on a percentage of turnover rather than profits. The percentage of turnover chosen is designed to reflect the likely level of taxable profits. In particular, fees for technical services are taxed using a presumptive method (section 44D and section 115A of the Income Tax Act of 1961). The rate of tax applied to turnover is less than rates applied to profits. The reason for the rate differential is to recognise that various costs need to be deducted from turnover, such as purchase of goods, overheads and wages and salaries. If an Indian permanent establishment of a foreign enterprise is taxed under the presumptive principle India will argue that the salary costs of personnel carrying out work for the permanent establishment which are met by the foreign Head Office have been "borne" by the permanent establishment. This is because the Indian Tax authorities will assume expenses have been borne by a permanent establishment where a tax deduction is allowed for those expenses. By

applying the presumptive method of taxation, the permanent establishment is effectively given a tax allowance for,*inter alia*, salary costs by virtue of enjoying a lower rate of tax, even where those salary costs have been wholly paid by the foreign Head Office. It is not necessary that a tax deduction for the salary costs should have been specifically claimed by the permanent establishment (*DHV Consultants BV* AAR ruling dated July 15, 2007). In circumstances such as these, the remuneration is deemed to have been borne by the permanent establishment and thus even remuneration from assignments of less than 193 days will be taxable in India.

Treatment of stock options

The treatment of employee stock options is not expressly dealt with and can be difficult as entitlement to the benefit taxable as a result of the option may have accrued partly whilst the employee was working temporarily in one of the States but there may be no taxable event, such as exercise of the option until the employee returns to the other State. A State is permitted to tax that part of the taxable benefit that can be related to the portion of the entitlement period spent working in that State.

Determining the extent to which an employee stock option benefit is derived from employment exercised in a particular State has to be done on a case by case basis, taking into account all relevant facts and circumstances. Whether a period of employment would be considered in allocating taxing rights between two States would depend on whether the entitlement to exercise the stock option was contingent upon continuing employment during that period. If an option was granted with a right to exercise, say, in three years' time, regardless of continuing employment then time elapsing between grant and exercise would not count towards an apportionment of the taxing rights over the benefit in the absence of any other factors.

Periods of employment before the option was granted may be considered in the apportionment of taxing rights if the grant of the option was contingent upon a minimum period of employment or attainment of performance objectives.

Once the option is exercised, any further benefit to the employee, normally in the form of a capital gain on a disposal of the shares at a profit, will be dealt with under Article 13 and so probably only taxable in the State where he is resident.

If the shares do not vest irrevocably on exercise of the option (e.g. because they are liable to forfeiture upon certain conditions) then the increase in value of the shares until they do vest irrevocably will also be dealt with as employment income and subject to the same considerations as the benefit arising between grant and exercise.

The method of apportioning stock option benefits recommended by the OECD is by reference to the proportion of the number of days during which the employment was exercised in one State to the total number of days of employment from which the entitlement to the stock option benefits were derived. Thus if an employee was required to work for an employer for 520 days in total during a particular time period to qualify for the benefits of the stock option and was sent to work in the other State for 260 days out of that period, then half of the stock option benefits would be taxable in each State.

Domestic law

India

Some local living allowances may be exempt as will travel allowances.

China

The extent of the taxation of expatriates depends on whether the stay is more than a year and whether it is more or less than five years. If the stay is for less than 90 days, then Chinese source income is taxable, except that employment income not borne by the Chinese employer is not taxed. (This corresponds to the rules set out in the Treaty, where the period is 183 days.) If the stay is for more than 90 days but less than a year, then Chinese source income, but not foreign income, is taxed in China. If the stay is for less than five years, then foreign income is usually exempt from Chinese tax. Only for stays of more than five years does full Chinese taxation apply.

Employer provided accommodation, travelling expenses, removal costs, and general household costs for expatriates are tax free.

China also permits an enhanced personal tax allowance.

Article 16 Directors' Fees

See treaty text.

These fees and other similar payments may be taxable in the country in which the company is resident as well as that in which the director is resident.

Article 17 Artists And Sportspersons

See treaty text.

The usual OECD Model rule is followed: Income derived by a resident of one State as an entertainer, such as a theatre, motion picture, radio or television artist, or a musician, or as an athlete, from their personal activities as such exercised in the other State may be taxed in the other State. This also applies where the income accrues not to the entertainer or athlete himself, but to another person, e.g. a management company or a troupe, team or orchestra forming a legal entity or to an artist company. This rule does not apply if the activities of the artist or athletes whose visit to the other State is supported to a considerable extent out of public funds of one of the States or where the visit is made under a cultural or sporting exchange between the two States.

Article 18 Pensions

See treaty text.

These are taxable only in the State where the recipient is resident.

However, pensions paid by the Governments of their local authorities are taxable only in the paying State. This is per the UN Model Treaty.

Article 19 Remuneration And Pensions In Respect Of Government Service

See treaty text.

Not analysed.

Article 20 Payments Received By Professors, Teachers And Research Scholars

See treaty text.

Teachers and researchers resident in one State can work in the other State for a period of up to three years and remain taxable only in the State of residence. There are no restrictions on the type of research involved. The work done must be at a university, college, school or other recognised educational or scientific institution. This is a fairly generous provision as the normal rule is two years only. Any research must be in the public interest and not primarily for the benefit of private persons or enterprises.

Article 21 Payments Received By Students, Trainees And Apprentices

See treaty text.

Copious provisions are made:

Certain payments received by a student or trainee, who is a resident of the other Contracting State and who is present in the visited State solely for the purpose of his education or training will be exempt in the visited State on:

• All payments for the purpose of his maintenance, education, or training. These must be made by persons resident outside the visited State;

• Grants, scholarships and awards supplied by the Government or a scientific, educational, cultural or other tax-exempt organisation; and

• Income derived from personal services performed in the visited State for the purpose of maintenance.

The exemptions only continue for a period reasonably or customarily required to complete the education or training and for no longer than five consecutive years in any case.

Article 22 Other Income

See treaty text.

Any income not dealt with in the preceding Articles is taxable only in the State of residence but if it arises in the other State then the other State may tax it according to domestic law. Thus the default position regarding the two States is that the State of source has primary taxing rights. Income not arising in either State may only be taxed by the State of residence. These rules follow the UN Model Treaty.

There is an express provision that income in respect of rights or property which is connected to a permanent establishment is taxed under Article 7 as the income of that permanent establishment. Income from immovable property remains taxable under Article 6 in the State in which the property is located.

Article 23 Methods For The Elimination Of Double Taxation

See treaty text.

China

The credit method is used, but with credit for underlying tax on Indian dividends where the dividend is received by a Chinese company owning at least 10% of the shares of the paying company.

India

India uses the credit method. No credit is permitted for Chinese corporation tax underlying dividends either under this Treaty or under the Indian domestic law.

Tax sparing

There is a reciprocal provision: The tax to be credited is deemed to include tax which would have been payable but for provisions in the State where the income arises giving tax reductions, exemption or any other tax incentives for the promotion of economic development. There is no time limit on this provision.

Article 24 Non-discrimination

See treaty text.

The usual OECD provisions, that nationals of one of the States shall not be subjected in the other State to any taxation or any requirement connected with tax, which is other or more burdensome than the taxation and connected requirements to which nationals of the other State in the same circumstances are or may be subjected.

There is no provision permitting India to tax a permanent establishment of a Chinese enterprise at a higher rate than would be charged to an Indian enterprise.

Article 25 Mutual Agreement Procedure

See treaty text.

The usual provision founding the OECD Model is used but with different time limits. Where a person considers that the actions of one or both of the States result or will result for him in taxation not in accordance with the provisions of this Treaty, he may present his case to the competent authority of the State of which he is resident. This is so irrespective of the remedies provided by domestic law. The time limit for bringing a claim is three years from the first notification of the action (e.g. notice of assessment) which gives rise to the disputed taxation.

However, any double taxation resulting from transfer pricing adjustments may be eliminated by agreement of the two States using the Mutual Agreement article of this Treaty.

Article 26 Exchange Of Information

See treaty text.

The scope of this Article is quite wide ranging in that it provides for exchange of such information as is "necessary for carrying out the provisions of the Agreement", for the purposes of domestic law of the two States and also for the prevention of fraud and tax evasion. The exchange of information is not limited to that only concerning persons who are residents of one of the States.

The Article includes the usual provisos relieving the States from any obligation to:

• Carry out administrative measures at variance with the laws or administrative practices of either State;

• Supply information which is not obtainable under the laws or in the normal course of the administration of either State; and

• Supply information which would disclose any trade, business, industrial commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy (*ordre public*).

There is no requirement to supply any information that the requested State would not need for its own tax purposes. Neither is there any bar on declining a request solely due to secrecy concerns.

The Protocol envisages the exchange of information on a routine basis as well as upon request.

Article 27 Diplomatic Agents And Consular Officers

See treaty text.

Not analysed.

Article 28 Entry Into Force

See treaty text.

Not analysed.

Article 29 Termination

See treaty text.

Not analysed.